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Energy Strategy Submissions
Department of State Growth
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Dear Sir/Madam

Energy Strategy Issues Paper

TasNetworks welcomes the publication of the Government's Issues Paper on its energy strategy for Tasmania, and the opportunity to lodge this submission.

The establishment of TasNetworks on 1 July 2014 resulted from the merger of the electricity distribution and transmission networks in Tasmania. Cost efficiency and lower prices to customers were the central focus of the merger decision, together with the creation of a sustainable business. TasNetworks is committed to delivering these cost savings, as demonstrated by our recent transmission revenue proposal to the Australian Energy Regulator (AER).

In looking to the future, TasNetworks recognises that we must do more than simply deliver cost savings. In particular, the use of the electricity network is changing fundamentally as technology provides new opportunities and alternative options for meeting customers' energy requirements. TasNetworks must be responsive to this changing environment, by listening more to customers and ensuring that the services we provide are tailored to meet their needs. We are already making progress in this regard and we look forward to working with our customers to deliver this outcome.

The structure of network prices is one area of particular focus for TasNetworks in the coming months. There is a growing realisation nationally that networks must set prices in a more cost reflective way, so that the price signals to which customers respond are a true reflection of the underlying cost drivers of the network. Such an approach ensures that customers pay according to the costs they impose on the network. When network prices reflect costs in this way, the network will be used and developed more efficiently and the total costs of providing network services will reduce. Another element of network prices is their inherent volatility. A key element of our strategy is building a framework for predictable and sustainable pricing for our customers. This is particularly relevant for our large transmission customers.

A number of customers have highlighted transmission charges as an area of focus for the energy strategy. Changes in transmission charges over the last decade reflected a period of significant investment in the ageing transmission system. This expenditure was essential to maintain reliability standards and meet area specific load growth. The changes also reflected increased operating costs associated with operation in the National Electricity Market and a higher cost of capital as a result of financial market conditions. Whilst price levels increased, a number of claims made as to 200% transmission price increases are inaccurate.



The seven largest transmission customers experienced a doubling (or 100% increase) of their charges in real terms over the period from 2006-07 to 2011-12 (an increase of 128% in nominal terms). Concerted cost saving efforts and a lower cost of capital in recent years have led to transmission charges moderating and now reducing: the seven largest customers have forecast 2014-15 charges that are less in nominal terms than their charges were in 2011-12. Transmission charges to our distribution customers have also fallen.

Comparisons of Tasmanian transmission charges with those experienced elsewhere by our customers should also be considered with some restraint. The design of the Tasmanian transmission system has been driven by the relatively decentralised nature of hydro generation and load. Comparisons with systems elsewhere can therefore be misleading. What should be considered in a more holistic discussion is the full delivered energy cost rather than just the cost of the transmission component.

The Issues Paper illustrates that over the last ten years rises in the delivered energy cost were experienced throughout Australia, including in Tasmania. This reflected increases in the wholesale energy price, rises in transmission and distribution network costs, and new charges to recover the costs of subsidising renewable energy schemes and for the carbon tax. As the Issues Paper also highlights, many of these contributions to delivered energy costs are now moderating in Tasmania.

More broadly, in developing the energy strategy for Tasmania it is important to have regard to the national context. From an electricity perspective the sector must operate within the regulatory parameters that are set and administered nationally.

In this context, getting the balance right between state-based and national initiatives is essential if we are to minimise the costs of red and green tape. For example, the role of the Tasmanian Energy Regulator should be focused only on those matters that are best addressed locally, rather than nationally. In the absence of this discipline, the energy sector and Tasmanian customers will be burdened unnecessarily by duplication of activities between state and national bodies.

TasNetworks is committed to the objectives set out in the Issues Paper whilst ensuring that the reliability of our network meets customer needs and the safety of our employees and the community is not compromised. We believe that delivering against our corporate plan will contribute to the achievement of those objectives. We recognise that TasNetworks has a vital role to play in providing the conditions that will retain and attract new loads to the electricity network, thereby facilitating economic growth for the benefit of Tasmania.

The attached document sets out our response to the Issues Paper, including answers to the questions posed. We look forward to working with the Government and the Energy Working Group as they develop and implement the energy strategy for Tasmania.

Yours faithfully



Lance Balcombe

Chief Executive Officer

TasNetworks' response to Energy Strategy Issues Paper

1. Introductory comments

The primary focus of the Issues Paper is to canvass the views of Tasmanian businesses and households. We welcome this approach, recognising that the Government's energy strategy must ultimately be concerned with delivering outcomes that benefit Tasmania. We also strongly support the Government's view that a stable and sustainable price path for power is a key ingredient to driving new investment and economic growth in Tasmania.

As the electricity network service provider, we have a central role in facilitating the Government's energy strategy. Following the extensive industry review conducted by the expert panel established by Parliament, TasNetworks commenced operating on 1 July 2014 following the merger of the transmission and distribution electricity networks in Tasmania.

TasNetworks' two shareholders are the Minister for Energy and the Treasurer. The shareholders' Statement of Expectations for TasNetworks includes the following strategic and commercial objectives:

- (i) deliver the lowest sustainable price for regulated services;
- (ii) ensure an appropriately safe, reliable and secure electricity supply;
- (iii) minimise operational and capital expenditure outlays through improved operational efficiency and asset management strategies;
- (iv) operate in accordance with sound commercial practice and ensure ongoing financial sustainability;
- (v) pursue a return on assets commensurate with the return set by the Australian Energy Regulator (AER); and
- (vi) seek to operate within the overall capital and operating expenditure allowances as determined by the AER.

We have reflected these objectives in our organisational structure and corporate plan. Importantly, by delivering on these objectives we will contribute to the Government's proposed energy strategy, which the Issues Paper describes in the following terms:

"The key objective of the Tasmanian Energy Strategy will be to identify ways in which energy can once again be utilised as an economic driver, including by securing a stable and sustainable price path for power that can provide relief to consumers and help grow the economy and attract new investment."

The Issues Paper correctly recognises that the Tasmanian energy strategy must have regard to the broader contextual issues. In this regard, there are two contextual aspects that we would like to emphasise in this submission:

- The technological and commercial environment is subject to ongoing change; and
- Energy policy has a strong national dimension, as the electricity and gas sectors are regulated by the AER in accordance with nationally determined rules.

This context has important implications for the scope and nature of the Tasmanian energy strategy. Specifically, the energy strategy must be capable of accommodating different ‘possible worlds’, as we cannot know with certainty our future energy needs or the most efficient means of meeting them. Furthermore, the Tasmanian energy strategy should be compatible with national arrangements, noting the significant benefits that Tasmania has already enjoyed through its participation in the National Electricity Market.

The remainder of this submission addresses the following issues which TasNetworks is well placed to comment on:

- Responding to new and emerging technologies;
- Providing better network pricing signals;
- Delivering cost efficiencies; and
- Streamlining regulation and reporting.

2. Responding to new and emerging technologies

The Issues Paper highlights the importance of new technology, particularly in relation to the electricity sector. These technological developments are driving change in the operation of our business and the businesses of our customers, including generators and end-use consumers. We therefore concur with the views expressed in the Issues Paper that technological change provides significant challenges and opportunities for the electricity network.

In particular, we support the uptake of electric vehicles. We concur with the Issues Paper that electric vehicles have the potential to add significant load in Tasmania, to the benefit of the broader economy. Furthermore, we also agree that appropriate incentives are essential for ensuring that recharging does not significantly increase peak load. As electric vehicles can provide energy storage capability, growth in their take-up is also a significant opportunity for Tasmania’s wind and renewable generation sector.

Our role as the network service provider is to ensure that we facilitate and embrace innovation and technological development. For example, we are currently developing our smart network strategy with a view to enable us to integrate flexible distributed generation sources, energy storage systems and demand side management to maximise use of existing infrastructure without compromising system security. The development of this strategy will facilitate improvements in the management of the electricity network, enable us to reduce costs by working assets even harder, and defer new investment without compromising safety or reliability.

In addition to developing strategies that facilitate and embrace technological change, we must also ensure that we deliver value for money to our customers. While effective cost management has an important role to play in this regard, network prices must also be set in a manner that facilitates and accommodates change in the way customers use the network. This network pricing is addressed in the next section.

3. Providing better network pricing signals

We concur with the commentary set out in section 2.5 of the Issues Paper, which notes that current regulated tariff structures do not send appropriate price signals to customers regarding the costs of using electricity during periods of network congestion. We agree that this situation is likely to contribute to inefficient use of the system and increased network costs.

This situation has been highlighted recently as the level of solar photovoltaic (PV) installations has increased. Generally, solar PV systems do not contribute to a reduction in peak demand which is what electricity networks are built to manage. This is particularly true for Tasmania where peak demand generally occurs on cold winter mornings when output from solar PV systems is minimal. Given solar customers generally pay lower network charges due to their lower consumption levels, current consumption-based tariffs result in these customers being cross-subsidised by other network users. This is on top of the subsidy already received by some solar customers who receive the grandfathered solar feed-in tariff. This is paid by TasNetworks and is projected to cost \$11 million in 2014-15.

The Issues Paper explains that the commercial environment in which the electricity networks operate has changed markedly in recent years. The recent declines in electricity demand in part reflect the technological developments that are providing competitive alternatives to electricity networks. Given these changes, and the increased risk of stranded assets, network pricing has an important role in ensuring that networks continue to meet customers' needs. In particular, prices that reflect the cost of service provision will assist in minimising network costs, enable networks to ensure that the optimal economic development of competing alternative technologies occurs, and ensure that customers pay 'fair' prices for network services. This will also assist in removing the current cross-subsidies that exist between customer types.

Not surprisingly, a national debate regarding network pricing is beginning to emerge. The Grattan Institute recently published a paper, *Fair Pricing for Power*, which proposed peak pricing arrangements for distribution networks. The extent of the media coverage of the Grattan Institute's paper indicates the growing importance and interest in network pricing.

In addition, the Australian Energy Market Commission (AEMC) has recently published a draft determination on future distribution pricing arrangements. The AEMC has proposed new pricing principles for electricity distribution, which require prices to be set to reflect the efficient costs of providing network services. Efficient prices allow consumers to make informed choices about their electricity consumption, and to compare the value they place on using the network with the costs caused by their consumption decisions. As already noted, this should, in turn, foster more efficient use and development of the networks, leading to lower overall costs for consumers.

We therefore strongly support the adoption of more cost reflective network prices, both in relation to transmission and distribution networks. As noted in our response to question 7, we consider that the tariff review proposed in the Issues Paper would be beneficial; however it must have regard to, and build on, the AEMC's determination on the national distribution pricing arrangements.

4 Delivering cost efficiencies

As explained in section 2.3 of the Issues Paper, our industrial customers are price-takers in global markets. Accordingly, they are seeking the lowest sustainable electricity costs.

In view of the cost pressures facing our customers, we have already delivered significant expenditure efficiencies and are striving for further savings. For example, capital expenditure on the transmission network for 2014–19 is forecast to be 52 per cent less than the current period, and controllable operating expenditure is also forecast to be 12 per cent lower.

Our recent transmission revenue proposal delivers a revenue reduction of nearly 18 per cent in real terms in 2014-15 compared with our revenue in 2013–14. Further reductions in transmission revenue are proposed for each of the subsequent four years of the next regulatory period.

As we prepare our distribution pricing proposal, our future revenue requirements will also be lower, reflecting merger efficiencies and our goal to reduce network investment. The cost of capital is also likely to make a strong contribution to a lower price path.

We are making concerted efforts to reduce our overheads, and to pass these savings on to our customers. For instance, we are intending to align our transmission and distribution regulatory determination periods and review processes to reduce duplication and associated costs. This move will also enable improved customer engagement about our plans for the merged electricity transmission and distribution networks. In addition to these initiatives, we have elected not to seek pass-through of the additional capital and operating costs we have incurred to facilitate the introduction of full retail competition. Instead, we will fund these costs from our existing allowances.

All of these measures have contributed to significant improvements in efficiency and reductions in costs, which will provide benefits to customers in the form of lower network prices. We will continue to strive for efficiency improvements, with the goal of achieving the lowest sustainable cost of providing network services to our customers.

Given the essential services provided by electricity networks, it is imperative that network assets are operated and maintained with a long term view. There have been a number of examples in other jurisdictions where reductions in expenditure (particularly on asset renewals) made for short-term fiscal reasons have had major negative implications in the longer term: infrastructure has failed and future expenditure has had to increase to return asset reliability to previous levels.

TasNetworks is currently developing long term asset management programs to support our future planning and delivery, so that our expenditure is more predictable and sustainable into the future.

5. Streamlining regulation and reporting

The Issues Paper recognises the importance of reducing unnecessary regulation (red and green tape), whilst also ensuring that the reporting requirements provide the transparency necessary to drive efficiency improvements. However, a balance must be struck between the costs of the regulatory and reporting requirements and the benefits they are expected to deliver.

As explained in section 2.2 of the Issues Paper, Government, through its ownership role, already sets clear objectives for its businesses, and holds each business accountable for its performance. In addition, Right to Information processes, parliamentary scrutiny committees and other legislated reporting obligations provide a high degree of transparency.

As an electricity network service provider, TasNetworks must also comply with extensive health, safety and environmental laws, regulations and standards. Our regulated services (which produce over 90% of our revenue) are subject to extensive external reviews and independent scrutiny by the AER and are also subject to regulation under Tasmanian legislation.

Recent changes to the national regulatory framework have increased the level of scrutiny and information provision required during our revenue determination processes. These changes were intended to deliver better outcomes for customers. However they have also resulted in a significantly more expensive regulatory compliance burden. For example, in calendar year 2014 over \$1 million will be spent on audits of the new AER information requirements. This does not include the significant internal costs to prepare the information required. TasNetworks considers that lower cost approaches could deliver the same or better customer outcomes.

In light of this experience, rather than extending the current regulatory framework and reporting requirements, in our view there is scope to streamline the current arrangements by removing unnecessary, state-based electricity industry regulation.

For instance, there is currently duplication in jurisdictional and national regulatory and compliance reporting requirements. Removing this duplication and streamlining regulatory requirements would result in business efficiencies, reduced costs and lower prices for consumers. Further examples of opportunities for reduced or streamlined regulation include electricity licensing requirements and electrical safety legislative frameworks.

TasNetworks welcomes the opportunity to assist the Government in the identification of unnecessary regulation and red tape. In this regard, we also welcome the recent creation of the Regulation Reduction Coordinator position, which is responsible for deregulating the business environment in order to boost productivity and reduce operating costs. Given that regulation is a significant cost to the business, which is ultimately borne by customers, we believe that the focus should be on streamlining the existing regulatory and reporting requirements, rather than extending them.

TasNetworks will also continue to advocate for lighter-handed, more incentive-based national regulation.

6. Concluding comments

TasNetworks supports the Government's development of a Tasmanian Energy Strategy. In particular, we share the Government's view that sustainable energy prices are crucial to Tasmania's future economic growth.

Given the recent pace of technological development, the most efficient means of satisfying our future energy requirements cannot be predicted with any degree of confidence. Given this uncertainty, it is important that Tasmania's energy strategy is sufficiently flexible to accommodate different 'possible worlds', while also having regard to the national regime for regulating the electricity sector. In this context, TasNetworks regards its role as one of facilitating and accommodating the efficient use of the electricity network and the efficient development of alternative technologies, to satisfy Tasmania's energy requirements whilst providing valued services to our customers.

TasNetworks' answers to questions in the Energy Strategy Issues Paper

Question 1 - What enhancements could be made to regulatory frameworks to ensure the right incentives for businesses and consumers are in place?

National regulation has recently been amended to strengthen provisions aimed at ensuring that regulated revenue allowances reflect efficient costs. These arrangements provide enhanced incentives for regulated businesses to improve performance. They have also imposed a range of new obligations on network businesses, including greater reporting and auditing requirements.

The key immediate challenge for regulation is to supplement the changes that have been made in relation to revenue regulation, by improving the current arrangements for setting network prices. In this regard, we note that the AEMC has recently issued a draft determination on distribution pricing. One of the changes proposed by the AEMC is to require distribution network prices to be more cost reflective.

As explained in the main submission, cost reflective network prices provide important incentives to customers, because they signal the true costs of using and expanding the capacity of the network, recognising that this cost varies depending on location and the level of asset utilisation. Cost reflective price signals should, therefore, encourage customer behaviour that will ultimately lead to lower network costs and lower prices for all customers.

Whilst more cost reflective pricing will lead to overall lower prices, it will also mean that those customers who are currently beneficiaries of the built in cross subsidies of the present pricing arrangements will likely pay more, whilst those who are contributing to the cross subsidies will no longer do so. The result nevertheless, will be a positive sum gain for customers as a whole.

It is equally important that network prices are stable and predictable. In addition to the matters noted in our answer to question 5 below, we will be working with the national regulators and our customers, seeking to deliver transmission and distribution prices that are more stable and predictable than has historically been the case.

Question 2 - Given both the State and Commonwealth Governments are committed to reducing red and green tape, and that the electricity market is highly regulated and complex, what opportunities are there to reduce or remove regulation?

As noted in section 5 of our submission, in relation to electricity networks, the primary opportunity to reduce red and green tape is to remove the overlap of the respective roles of the jurisdictional and national regulators. In particular, there is scope to streamline the obligations and reporting requirements placed on TasNetworks by the Tasmanian Energy Regulator and the AER. We also consider that there is scope to streamline electrical safety regulation by reducing its complexity.

We would welcome the opportunity to provide more detailed suggestions regarding specific improvements that could be made.

Question 3 - Is retail competition important because of price, choice or for other reasons?

This question is best addressed by consumers. As a network service provider, our role is to facilitate retail competition.

Question 4 - What enhancements or additional information could increase the reporting transparency of the Government's electricity businesses and contribute to improved efficiency?

This issue is discussed in section 5 of our submission. As part of the recent amendments to national regulation, the AER has strengthened the reporting requirements on all regulated businesses. We now provide very significant amounts of detailed information to the AER, which the regulator analyses and publishes in annual benchmarking reports. The annual benchmarking reports are intended to provide all stakeholders with detailed information on the comparative performance of the network businesses.

As noted in our answer to question 1, it is early days under these new arrangements. However, we expect the additional information received and published by the AER to enhance the reporting transparency of network businesses, and provide increased impetus for the businesses to strive to improve performance. We note that the collation and auditing of this information is very expensive, so we would urge careful consideration of the costs and benefits before any further information reporting requirements are imposed on us.

Question 5 - Do energy intensive and trade exposed businesses require greater future price certainty to maintain and/or grow their operations?

The issues paper notes that major industrial customers in Tasmania have been able to obtain certainty with respect to the wholesale energy component of their costs, but not the network component. Feedback from our customers is that the recent level of volatility in network prices has been undesirable.

We recognise the need for these customers to have reasonable certainty regarding network prices. Under regulatory and pricing frameworks our ability to provide certainty is limited because some of the sources of volatility are outside our control. For example, national arrangements for managing intra-regional settlement residues.

We recognise the current arrangements need to change. A key plank of our strategy is for TasNetworks to negotiate prices with large customers to provide more predictable and sustainable price paths. This is likely to require both TasNetworks and our customers to accept some new risks.

Question 6 - Would you consider accepting slightly lower levels of reliability if this resulted in materially lower prices?

This is primarily a question for consumers. However, we engaged with consumers on this issue in preparing our recent transmission Revenue Proposal, and it is therefore useful to set out some observations below.

Our consumer engagement strategy included large industrial customers and input from a wide cross-section of consumers who are connected to the distribution network. This approach provided useful insights to the optimal trade-off between price and reliability. In particular, consumers indicated that:

- The risk of a less reliable service was not acceptable as a trade-off for lower prices.
- By the same token, an increase in reliability was also not supported if it came at a higher price.

Our transmission revenue proposal took account of this feedback by focusing on delivering cost efficiencies that would not compromise existing service levels.

We will continue to strengthen our consumer engagement activities, to gain a more detailed understanding of consumers' preferences regarding the trade-off between reliability and prices. We note, however, that it is unlikely that immediate savings in network costs could be achieved by reducing reliability standards as significant investments in long-life transmission and distribution assets have been made to meet current reliability standards.

Question 7 - Would a review of tariff structures be desirable, in terms of minimising total network costs and allocating costs fairly?

As explained in section 3 of this submission, we consider that there would be merit in a review of network tariffs in Tasmania, including reflecting the outcomes of the current distribution pricing rule changes being finalised by the AEMC.

The migration to more efficient and cost-reflective tariffs will lead to 'winners' and 'losers' along the way, so it will be important for the transition to be managed carefully. In this context a review of tariff structures would be an effective vehicle for engaging all stakeholders in the discussion, and garnering the necessary community support for change.

Question 8 - What approach, including non-regulatory ones, should Government consider for improving the thermal efficiency of our buildings?

Whilst supporting efficient use of energy, TasNetworks does not have a view on this question.

Question 9 - What approach to energy efficiency should Government use to help improve productivity for small to medium businesses, and to reduce energy bills for households?

This question is best addressed by electricity consumers.

Question 10 - What role should Government play in attempting to retain and increase load growth in Tasmania and how should it do it?

The question of the role to be played by Government in attempting to retain and increase load growth is ultimately a matter for Government to determine, based on a clear understanding of the net economic benefit of all policy options.

TasNetworks notes the recent creation of the Coordinator-General position to assist the development of an integrated approach to supporting business investment. TasNetworks will fully co-operate with and assist the Coordinator-General as required.

We note that the Issues Paper suggests that Government could accept a lower return on equity in exchange for lower delivered energy prices, which could attract new industries and promote greater economic growth for Tasmania. TasNetworks considers it appropriate for the Government to fully consider this. However in considering this the Government must balance the substantial investment it holds in TasNetworks and the impact on its future returns, particularly when TasNetworks has the strategic objective to pursue a return on assets commensurate with the return set by the AER.

Question 11 - What further potential is there to develop renewable energy in Tasmania, including wind energy, given there is no unmet Tasmanian demand requiring additional generation for the foreseeable future?

As discussed in section 2 of this submission, TasNetworks agrees with the view expressed in the Issues Paper that electric vehicles provides a potential growth opportunity for load and may support renewable generation in Tasmania.

Question 12 - Is there a further facilitation role for Government in gas roll-out, or should Government focus its efforts on examining the costs and benefits of improving minimum protections for gas customers?

TasNetworks does not have a view on this question.

Question 13 - What are considered to be the key opportunities, and the key issues, associated with possible energy futures?

The discussion in section 2 of the main submission addresses this question.

Question 14 - What could be some outcomes for the Tasmanian Energy Strategy, and what actions can government, or energy providers and consumers take to achieve them? How could success/performance be measured?

As explained in the covering submission, it is important to recognise that Tasmania's future energy needs, and the most efficient means of addressing them, cannot be known with certainty. In this context, the energy strategy should provide a commercial and regulatory environment that enables Tasmania to take advantage of any emerging opportunities.